

On November 6, 2012, Michigan voters will decide whether to adopt an amendment to the Michigan Constitution that would require a two-thirds majority vote of both the State House and the State Senate, or a statewide vote of the people at a November election, in order to impose new taxes, increase the rate of taxation, or expand the base of taxation. Proposal 12-5 is the result of a citizens' initiative petition circulated among electors for qualifying signatures, and will appear on the ballot as follows:

**A PROPOSAL TO AMEND THE STATE CONSTITUTION TO LIMIT THE ENACTMENT OF NEW TAXES BY STATE GOVERNMENT**

*This proposal would:*

*Require a 2/3 majority vote of the State House and the State Senate, or a statewide vote of the people at a November election, in order for the State of Michigan to impose new or additional taxes on taxpayers or expand the base of taxation or increasing the rate of taxation.*

*This section shall in no way be construed to limit or modify tax limitations otherwise created in this Constitution.*

*Should this proposal be approved?*

If a majority of electors vote "yes", Proposal 12-5 will add Section 26a to Article IX of the State Constitution.

**Background**

The Michigan Constitution contains a variety of tax limitations, although the nature of most of them is to specify revenue limits and/or specific parameters of tax law, rather than the threshold necessary to alter taxes. Examples of these limitations include:

- Article IX, Section 3: Specifies that assessed value must be 50% of true cash value, and that, unless a change in ownership occurs, the taxable value of a parcel of property may not increase by more than the lesser of 5%

or the increase in general price level during the immediately preceding year.

- Article IX, Section 6: Specifies the maximum millage rates that may be levied under general ad valorem property taxes.
- Article IX, Section 7: Prohibits a graduated income tax, whether by base or rate.
- Article IX, Section 8: Specifies the maximum sales tax rate that may be levied.
- Article IX, Section 26: Specifies an aggregate limit, as a percentage of personal income, on the amount of revenue that the State may receive from taxes and revenue sources other than Federal aid.

Several existing constitutional provisions require a vote of the people, or specify higher voting thresholds from the Legislature. The following are examples of these provisions:

- Article IX, Section 6: Requires a vote of the people to increase the maximum number of mills levied on property to 50 mills.
- Article IX, Section 3: Requires a three-fourths majority vote of both the House and the Senate in order to increase the maximum number of mills levied for school operating purposes above the level in effect on February 1, 1994.
- Article IX, Section 27: Allows the revenue limit in Section 26 to be exceeded if an emergency is declared by a two-thirds vote of each legislative chamber.

**Fiscal Impact**

Whether Proposal 12-5 would have a fiscal impact on tax revenue and tax policy depends on the votes that would be made on future legislation. As a result, both the legislation and the votes are unknown and it is impossible to offer a prospective fiscal impact. However, it is possible to look back and examine how many bills that created a new tax, increased the rate of taxation, and/or expanded the tax base would have met the proposed requirement of at least a two-thirds vote of both chambers, assuming the votes would have been unchanged if the proposal had been part of the Constitution at the time those votes were taken.

Votes on bills were examined for the following taxes: Individual Income Tax, Business Activities Tax, Corporate Income Tax (both the tax established in 1967 and in 2011), Single Business Tax, Michigan Business Tax, Unemployment Insurance Tax, Foreign Insurance Company Retaliatory Tax, Oil and Gas Severance Tax, Sales Tax, Use Tax, Cigarette and Tobacco Tax, Liquor Tax, Beer and Wine Tax, State Education Tax, Real Estate Transfer Tax, Motor Vehicle Registration taxes/fees, Motor Fuel Tax, Inheritance Tax, Estate Tax, and General Property Tax Act (initial adoption only).

In the case of the initial adoption of these 21 taxes, only seven were adopted by two-thirds or greater majorities in both chambers: the Michigan Business Tax, the Unemployment Insurance Tax, the Foreign Insurance Company Retaliatory Tax, the Oil and Gas Severance Tax, the Use Tax, the Motor Fuel (Gasoline) Tax, and the Michigan Estate Tax (which replaced the Inheritance Tax).

In 39 instances, bills were enacted to increase the tax rate or expand the tax base. Only 13 of the bills were adopted by two-thirds or greater majorities in both chambers, including a veto override vote on a 1951 Motor Fuel Tax increase. At least two of the other votes that met the two-thirds threshold were actual or effective recodifications of existing taxes.

With few exceptions, such as the 1925 adoption of the Motor Fuel Tax, the 1997 Cigarette and Tobacco Tax increase, and the 1993 creation of the State Education Tax and Real Estate Transfer Tax as part of the Proposal A reforms, bills that have created a new tax, increased the rate of taxation, or expanded the tax base, whether or not they were adopted by a two-thirds majority of both chambers, have been enacted during Michigan and/or national recessions.

One secondary fiscal impact relates to borrowing costs. Rating agencies have indicated, both in ratings announcements regarding state debt and in their published ratings methodology, that the greater the constraints on generating revenue, particularly tax revenue, the lower the rating on the state's debt. Standard and Poor's

methodology assigns the most unfavorable scores to states that face both political and constitutional constraints to increase key revenue sources. Academic research has demonstrated that state spending limits are generally viewed favorably, and lower borrowing costs, while constitutional revenue restrictions are generally viewed unfavorably, and increase borrowing costs. A 1999 study estimated that the existence of constitutional limitations to imposing or increasing taxes added an average of 17 basis points to a state's interest rates, compared to states without these requirements. To the extent that local unit borrowing costs are often tied to this State's debt ratings, the adoption of Proposal 12-5 would likely increase borrowing costs for both the State and local units. The actual cost to the State and local units would depend on the circumstances of any future borrowing.

**Similar Limitations in Other States**

Several states impose higher requirements for the adoption of certain tax and/or revenue bills, and in some cases even budget or appropriation bills. Many of the requirements are constitutional in nature, including those in 13 of the states: Arizona, Arkansas, California, Colorado, Delaware, Florida, Kentucky, Louisiana, Mississippi, Nevada, Oklahoma, Oregon, and South Dakota. The provisions vary considerably in the taxes affected, limitations imposed, and adoption requirements.

Several related limits exist in Missouri, Washington, and Wisconsin. The Missouri Constitution stipulates a revenue limit (as Michigan does), and permits tax increases that would cause the revenue limit to be exceeded if approved by a two-thirds vote of both chambers (which Michigan does not allow). In 1993, Washington began requiring a two-thirds vote to pass any tax increase, but the threshold is established in statute rather than constitutionally. The statute was suspended in both 2002 and 2005. Like Washington, Wisconsin in 2011 enacted a statutory requirement for a two-thirds vote, or a vote of the people, to increase the tax rates under the sales tax, income tax, and franchise tax.

## Indeterminate Aspects of Proposal 12-5

The language of Proposal 12-5, especially when compared to similar requirements in other states, would have an indeterminate impact in a variety of situations. The proposed language does not define any terms, particularly "tax" or "base of taxation". Michigan already has some degree of legislative history trying to distinguish taxes from fees, and that history will become more relevant if the proposal is adopted. For example, it is unclear whether changes in vehicle registration fees or the liquor markup the State imposes on alcohol sales would fall under the requirements of Proposal 12-5.

In terms of the "base of taxation", it is unclear how narrow an interpretation would be applied under the proposed language. For example, from an economic perspective the tax base of the individual income tax is generally regarded to be "income", as opposed to sales, capital gains, or the value of property. From that base, taxpayers are generally granted exemptions and deductions. Without knowing the definition of "base of taxation" that would be applied, whether it would apply to the economic factor that could be taxed or the economic factor actually taxed, it is unclear whether a bill that would subject income from a particular source, such as veteran's benefits, would be affected by the proposed language. Similarly, it is unclear whether a bill that reduced the personal exemption would be affected by the proposal, since the personal exemption is a subtraction allowed from the income subjected to tax, but does not relate to whether or not a specific type of income is subject to taxation. Reductions in credits, such as the Homestead Property Tax Credit or the Earned Income Tax Credit, would appear not to be covered by the proposed language, especially given that these refundable credits are designed as offsets for other tax liabilities and are simply paid from income tax revenue.

Additionally, some State taxes follow the Federal treatment for aspects of the tax. The State generally follows Federal changes by default, but may adopt legislation to prevent the Federal changes from affecting State revenue. It is unknown how such legislation would be affected by the proposal or whether such legislation would be required, particularly if the Federal change increased the tax base.

The proposed language regarding the rate of taxation does not indicate whether it applies to the statutorily set tax rate or the effective tax rate. Like the Homestead Property Tax Credit and Earned Income Tax Credit, there are provisions that affect a taxpayer's final liability that do not reflect changes to the rate or base. Taxpayers are allowed to retain a portion of the sales tax they collect, and this retained amount effectively functions as a credit against the liability to the State. If legislation were to reduce the amount a taxpayer could retain, the statutory sales tax rate would remain at 6%, but the effective tax rate for the taxpayer would be higher.

Proposal 12-5 specifies that it applies to taxes the State would "impose" and it is unclear if that term would be interpreted to be synonymous with "levy" or "authorize". Depending on the interpretation of "impose", the proposal could affect a variety of locally levied taxes, including city income taxes, convention/tourism fees, city utility users tax, and hotel/accommodations taxes. Even though these taxes are generally subject to local elections, the State authorizes local units to levy such taxes, and generally specifies the maximum rates and certain other provisions.

At times taxes have been recodified, as occurred under the Beer Tax and the Motor Fuel Tax, or supplemented with surcharges that change neither the rate nor the base. It is not known whether these types of changes

would be treated as imposing a "new" or "additional" tax.

The effect of the proposed language on other types of tax changes is also unclear. In 2003, the collection of the State Education Tax was accelerated so that 100% of the tax was collected during the summer levy. To offset the cash-flow effects of the change, the rate was temporarily lowered to five mills for that year. It is unclear if the proposed language would have affected either the acceleration of the collection date or the subsequent change from five mills to six mills, or both. Similarly, numerous provisions in statute exempt a type of activity or property from one general tax and then subject it to a specific tax, in some cases at an identical rate and/or base and in other cases at a different rate or base, or provide for certificates that abate some or all of a tax liability. It is unknown to what extent the proposed language would affect modifications to these provisions.

Finally, some tax changes can reduce the tax base for some taxpayers while increasing it for others, and it is unclear how these types of changes would be affected by the proposed language. For example, changes in the way multistate income or business activity is apportioned to Michigan, or the way the accounting between related or affiliated firms is treated, can reduce the tax base of some taxpayers while increasing the tax base of other taxpayers.

An ample body of court decisions exists in states with requirements similar to Proposal 12-5, even in states where many of the terms were defined. Passage of Proposal 12-5 almost certainly would generate litigation, as the State and taxpayers sought clarity on applying the proposal's language.



# Senate Fiscal Agency

## NOVEMBER 2012 BALLOT PROPOSAL 12-5

An Overview

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